

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeene G. Kelly.

Southern Natural Gas Company

Docket Nos. RP02-86-001,
RP03-123-000,
RP03-123-001, and
RP04-79-000

ORDER ON TECHNICAL CONFERENCE AND REHEARING

(Issued February 17, 2004)

1. On April 3, 2003, a technical conference was convened to explore the issues raised concerning Southern Natural Gas Company's (Southern) tariff provisions governing the cash-out of imbalances. On April 11, 2003, Southern and the Municipals¹ filed proposals to modify Southern's cash-out mechanism. On April 25, 2003, parties filed initial comments to the technical conference that specifically focused on the cash-out proposals, and on May 9, 2003, parties filed reply comments. As discussed below, the Commission finds that there is insufficient evidence to modify Southern's cash-out mechanism pursuant to Section 5 of the Natural Gas Act (NGA). The Commission also denies pending requests for rehearing.

Background

2. On November 30, 2000, Southern filed tariff sheets to place into effect its annual reconciliation of its storage costs for 2001, pursuant to section 14.2(c) of its General Terms and Conditions (GT&C). Section 14.2 of the GT&C of Southern's tariff provides for an annual reconciliation of Southern's storage costs to reflect differences between the cost to Southern of its storage gas inventory and the amount Southern receives for such

¹ The Municipals are comprised of Alabama Municipal Distributors Group, the Austell Gas System, the Southeast Alabama Gas District, the Municipal Gas Authority, and Alabama Gas Corporation.

gas arising out of: (i) the purchase and sale of such gas in order to resolve shipper imbalances pursuant to the cash-out mechanism in section 14.1 of the GT&C; and (ii) the purchase and sale of gas as necessary to maintain an appropriate level of storage gas inventory for system management purposes.

3. Alabama Gas Corporation (Alabama Gas) protested that section 14.2 of the GT&C fosters “gaming” on Southern’s system. Alabama Gas argued that Southern’s cash-out pricing mechanism and Storage Cost Reconciliation Mechanism (SCRM) (collectively, cash-out provisions) in sections 14.1 and 14.2 of its GT&C, respectively, unjustly and unreasonably permit the balancing parties to game the system and engage in cash-out arbitrage resulting in increased costs to Southern’s customers. Alabama Gas pointed out that the index price used in Southern’s cash-out mechanism is the average gas price for the month, which, at least toward the end of the month, can be predicted accurately. Alabama Gas noted that in times of price volatility, when the average gas price for the month is lower or higher than the actual price at the end of the month a shipper can game the system by purchasing more gas before the end of the month if the average price is lower, or less when higher.

4. The Commission accepted Southern’s filing subject to refund and conditions and denied Alabama Gas’s protest, stating that Southern was merely seeking to implement a provision of its tariff that had been previously approved.² The Commission also stated that Alabama Gas could raise the issue in Southern’s proceeding to comply with Order No. 637.³ On November 30, 2001, Southern filed tariff sheets to place into effect its annual reconciliation of its storage costs for 2002. Alabama Gas and the Municipals again protested the filing. On February 13, 2002, the Commission accepted the filing and invited the parties to discuss the issue raised by the protest as part of Southern’s Order No. 637 proceedings.⁴ Alabama Gas requested rehearing, contending that the Commission erred in refusing to investigate the allegations that the SCRM was unjust, unreasonable, and unduly discriminatory.

5. On April 11, 2002, the Commission accepted, subject to modification, a proposal by Southern to settle its Order No. 637 compliance proceeding in Docket No. RP00-476-

² Southern Natural Gas Co., 93 FERC ¶ 61,325 (2000), reh’g denied, 94 FERC ¶ 61,197 (2001).

³ Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, FERC Stats. & Regs., Regulations Preambles [July 1996-Dec. 2000] ¶ 31,091 (Feb. 9, 2000); order on reh’g, Order No. 637-A, FERC Stats. & Regs., Regulations Preambles [July 1996-Dec. 2000] ¶ 31,099 (May 19, 2000).

⁴ Southern Natural Gas Co., 98 FERC ¶ 61,126 (2002).

002.⁵ Southern's settlement proposal included revisions of Southern's cash-out mechanism. These included a change to its cash-out index price to make it less predictable during the month and thus discourage arbitrage. While the Commission generally approved the settlement, the Commission found that the settlement's proposed changes to Southern's cash-out mechanism were beyond the scope of Order No. 637. Therefore, the Commission required Southern to eliminate the proposed change to its cash-out mechanism. The Commission stated that Southern could propose changes to its cash-out mechanism in a separate proceeding under Section 4 of the NGA.

6. On November 27, 2002, Southern filed tariff sheets to place into effect its annual reconciliation of its storage costs for 2003. Protestors again contended that Southern's cash-out mechanism and its SCRM in section 14 of its GT&C contain flaws which result in gaming of the system that imposes unnecessary costs on shippers.⁶ On December 30, 2002, the Commission accepted and suspended the filing subject to refund and conditions. The Commission found that this proceeding was the appropriate forum to address the issues raised by the protestors. Accordingly, the Commission ordered that a technical conference be held to address such issues. Alabama Gas and Southern both requested rehearing. Alabama Gas continued to protest that the Commission must investigate whether aspects of the SCRM surcharge methodology are unjust, unreasonable, and unduly discriminatory. Southern contended that the Commission could only change its cash-out mechanism and its SCRM pursuant to NGA Section 5 and therefore erred by making the acceptance of the filing subject to refund. Southern contended that the Commission erred by issuing an order that imposes a refund obligation, a contention made moot since the Commission in fact ordered no refunds.

7. A technical conference was held on April 3, 2003. On April 11, 2003, Southern filed a proposal to modify its cash-out mechanism and SCRM similar to that which was previously proposed in its Order No. 637 proceeding. Southern contended that the settlement of its last general Section 4 rate case, executed on March 10, 2000 (March 10, 2000 Settlement),⁷ prohibited it from proposing a change to its cash-out mechanism pursuant to Section 4 of the NGA because the March 10, 2000 Settlement included a moratorium on proceedings initiated by Southern under Section 4 of the NGA with an effective date prior to March 1, 2004.⁸ Therefore, Southern asked that the Commission act under NGA Section 5 to approve Southern's proposal to modify its cash-out

⁵ Southern Natural Gas Co., 99 FERC ¶ 61,042, at 61,162-63 (2002).

⁶ Southern Natural Gas Co., 101 FERC ¶ 61,397 (2002).

⁷ See Southern Natural Gas Co., 91 FERC ¶ 61,206 (2000) (approving uncontested settlement).

⁸ See March 10, 2000 Settlement, Article IV.

mechanism. The Municipals also filed a proposal to modify Southern's cash-out mechanism.⁹

Proposals

8. Southern proposes several changes to the price at which imbalances would be cashed out. Southern proposes to add to the calculation of the index price, the Natural Gas Intelligence end of month price for "Louisiana-Southern Natural Gas Spot Average."¹⁰ As referred to by Southern, majority imbalances are imbalances in the direction of the system imbalance, and minority imbalances are imbalances in the opposite direction of the system imbalance. For resolution of majority imbalances in the greater than 2 percent to 5 percent tier, the index price will be the highest or lowest of the prices for each week or the monthly price, including the end of month price, depending on whether a shipper is short or long, respectively. For resolution of majority imbalances above 5 percent, existing pricing tiers in the tariff will be retained, with the cash-out price based on the high-low price used in the 2-5 percent tier. Southern proposes to use the existing index price without the addition of the end of month price to resolve minority imbalances, and also proposes to eliminate tiering for resolving minority imbalances. Southern will post the index prices for the month about the eighth business day of the following month.

9. The Municipals propose to calculate the cash-out price for a majority imbalance shipper on the highest weekly average price (if majority shipper owes gas to the system), or the lowest weekly average price (if majority shipper has left gas on the system), by using the weeks during the month in which the imbalance occurs plus the first weekly average index price in the month following the delivery month. That price would be

⁹ Subsequent to this action, on November 26, 2003, Southern filed tariff sheets to place into effect its annual reconciliation of its storage costs for 2004. On December 31, 2003, the Commission accepted and suspended the revised tariff sheets to become effective January 1, 2004, subject to refund and conditions and the outcome of the proceedings in Docket No. RP03-123-000. Southern Natural Gas Co., 105 FERC ¶ 61,401 (2003).

¹⁰ Southern proposes for majority imbalances in the 0-2 percent tier, the index price will be calculated by (i) adding (x), the product of the average weekly and monthly prices for the month multiplied by the total system minority imbalance, to (y), the product of the highest or lowest weekly or monthly price, depending on whether the total system imbalance is short or long, respectively, multiplied by the total net system imbalance; and (ii) divide the sum of the two products in (x) and (y) by the total system majority imbalance to arrive at the Majority Index Price.

increased by 10 percent if the shipper owes gas and has an imbalance greater than 2 percent of the total quantity of gas delivered by the shipper during the month. The Municipals recommend allocating a portion of the costs of the SCRM to supply poolers based upon the quantity of gas cashed out during the delivery month.

Comments

10. Commenters address Southern's ability under the rate moratorium provision of the March 10, 2000 Settlement to modify its cash-out provisions pursuant to Section 4 of the NGA, as well as the standard for any modification pursuant to Section 5 of the NGA. Substantive comments consider the mechanics of the two proposed cash-out methodologies, the lack of evidence demonstrating operational problems caused by the existing cash-out mechanism, and the Municipals' proposal to charge part of the SCRM to the supply poolers.

Cash-out methodology

11. Southern presents almost three years worth of data that Southern states show a high correlation between the arbitrage opportunity (represented by the difference between Southern's existing index price and the end of the month price) and the total net imbalance volume for the delivery month.¹¹

12. Duke Energy Trading and Marketing, L.L.C. and Duke Energy Fuels, L.P. (collectively, DETM) and the Indicated Shippers generally oppose any change in the current SCRM and cash-out mechanism on the basis that neither had been proven to be unjust and unreasonable. DETM asserts that Southern and the Municipals have failed to proffer evidence that any operational basis exists for implementing changes to Southern's cash-out mechanism,¹² or that any operationally-significant arbitrage exists.¹³ DETM also points out that the surcharge had already been reduced to insignificant levels in the most recent year. DETM and Indicated Shippers argue that Southern's proposed formula for calculating the cash-out price would have excessively penal effects.¹⁴

13. Southern, Georgia Industrial Group (GIG), Southern Company Services (SCS), and Atmos Energy Corporation (Atmos) all favor adopting Southern's proposal. GIG,

¹¹ Southern Initial Comments at 5-6 and Attachment at "Arbitrage Price Differential".

¹² DETM Initial Comments at 2-3 and n.4.

¹³ DETM Initial Comments at 3; Reply Comments at 3.

¹⁴ DETM Reply Comments at 5; Indicated Shippers Initial Comments at 12-13.

SCS, and Atmos concur that the Municipals' proposal would be too harsh or punitive. GIG, SCS, and Atmos state that Southern has sufficiently shown an existing opportunity for arbitrage and that the new mechanism would introduce enough uncertainty into the cash-out price calculation to significantly reduce any gaming of Southern's system. GIG also states that the parties responsible for the arbitrage should be identified and held accountable for all of the increased costs recovered through the SCRM. Southern and the Municipals also note shippers' reliance on Southern's cash-out mechanism instead of taking advantage of other methods to reduce their monthly cash-out imbalances, such as trading imbalances or park and loan services.

Operational impact

14. Southern claims that arbitrage forces Southern to use its retained storage to cover more than just ordinary imbalance activities, creating a potential threat to system reliability. While Southern admits arbitrage has not, by itself, caused Southern to issue any operational flow orders (OFO), Southern contends that such gaming does stress the system.¹⁵ DETM states that Southern has failed to produce any evidence that shippers' net imbalances are creating any operational problems on Southern's system.¹⁶

Allocation of SCRM costs to supply poolers

15. GIG and SCS support the Municipals' proposal to charge costs related to the SCRM to supply poolers. GIG and SCS contend that the poolers contribute to the costs recovered through the SCRM. GIG states that any charge should be allocated to poolers based upon the average volume in a pool from a given receipt point. Southern states that charging the supply poolers a portion of the SCRM would constitute a new rate, thereby violating the terms of the rate moratorium in the March 10, 2000 Settlement. DETM argues against allocating part of the costs to poolers, contending that pooling transactions are purely administrative in nature, involve no actual transportation, and therefore are not collectible under the SCRM. DETM and Southern also question the fairness of the proposed allocation methods. Indicated Shippers note that only 16 percent of the imbalances on Southern's system from January 2002 through February 2003 were the responsibility of supply poolers.¹⁷ Indicated Shippers state that there is no Commission precedent to charge transportation-related rates to non-shippers, and that such a charge would inhibit the creation or development of pooling areas in violation of Order No. 636.¹⁸

¹⁵ Southern Initial Comments at 7.

¹⁶ DETM Initial Comments at 3.

¹⁷ Indicated Shippers Reply Comments at 7-8.

¹⁸ Indicated Shippers Reply Comments at 8 and n.8.

Discussion

16. Parties have protested each of Southern's annual SCRM filings since 2000, asserting that flaws in Southern's cash-out mechanism permit customers to engage in arbitrage to the detriment of Southern's other customers. While the Commission initially stated that parties could raise this issue in Southern's Order No. 637 compliance proceeding, the Commission subsequently determined that this issue was not appropriately addressed in that proceeding. Therefore, when this issue again arose in connection with Southern's SCRM filing for 2003, the Commission established a technical conference to provide the parties a full opportunity to present evidence and air their views on the need to modify Southern's cash-out mechanism. A major threshold issue is whether the March 10, 2000 rate case settlement permits Southern to propose a change in its cash-out mechanism pursuant to Section 4 of the NGA. If not, then the Commission could only modify the cash-out mechanism by taking action under Section 5 of the NGA to modify the settlement.

17. Article IV of the March 10, 2000 Settlement provides, with certain exceptions, that "Southern Natural will not initiate a proceeding under Section 4 of the NGA that will be effective prior to March 1, 2004 to increase these Settlement Rates as to consenting parties."¹⁹ A majority of the parties to the instant proceeding argue that Southern's March 10, 2000 Settlement does not permit Southern to modify its cash-out provisions under Section 4 of the NGA.²⁰ Southern concedes that it is prohibited from filing a Section 4 proceeding to be effective within the moratorium period to change its cash-out index price or SCRM.²¹ The Municipals, however, assert without elaboration that the language in the March 10, 2000 Settlement would not prevent Southern from making a Section 4 filing.²² It is ambiguous whether any modification of Southern's cash-out

¹⁹ See March 10, 2000 Settlement, Article IV, at 1. The moratorium discussed in Article IV prohibits Southern from initiating a Section 4 proceeding to increase the Settlement Rates with certain exceptions, to wit: the Annual Charges Adjustment and any other fees imposed by the Commission, Gas Research Institute, or other industry-wide surcharges permitted by the Commission to recover costs not otherwise recovered under the settlement; certain Gas Supply Realignment Surcharges; certain remaining Southern LNG minimum bill charges; the Storage Cost Reconciliation Deferred Account of Section 14.2 of the GT&C; and other exceptions specified in paragraphs 2 and 3 of Article IV.

²⁰ See Indicated Shippers Initial Comments at 2; DETM Reply Comments at 2 n.2.

²¹ Southern Initial Comments at 10; Southern Reply Comments at 2. See March 10, 2000 Settlement, Article IV. Id. at 1.

²² Municipals Reply Comments at 4 n.4.

provisions would amount to an increase in “Settlement Rates” as prohibited by the rate moratorium. It is likewise ambiguous whether such cash-out provisions are clearly counted among the prohibited modification of “the cost allocation, rate design, services, or billing determinants which underlie the rates established” in the March 10, 2000 Settlement. The Commission finds that the better argument on balance is that the rate moratorium in the March 10, 2000 Settlement prohibits Southern from proposing to modify its cash-out mechanism under Section 4 of the NGA. The March 10, 2000 Settlement includes an express listing of what rate changes are exempted from the rate moratorium. That listing does not include changes in the rate that must be paid to cash-out imbalances. Moreover, the Commission gives weight to the fact that most of the parties to the March 10, 2000 Settlement interpret the rate moratorium as applying to the cash-out mechanism. In any event, Southern has not made a Section 4 filing to modify its cash-out provisions at this point. Therefore, change to Southern’s cash-out provisions can only be effected through action under Section 5 of the NGA.

18. The Commission will not exercise its discretion to take action pursuant to Section 5 of the NGA, based upon the facts in evidence in the instant proceeding.²³ A major purpose of a rate case moratorium in a settlement is to provide rate certainty to the parties.²⁴ Accordingly, the Commission would only take Section 5 action to modify the rates subject to the rate moratorium in extraordinary circumstances. In Texas Eastern,²⁵ the Commission found that if a settlement rate moratorium is in effect that includes a moratorium or changes in the pipeline’s cash-out mechanism, as in the instant case, the Commission would not take action under Section 5 of the NGA to modify the cash-out mechanism unless there is sufficient evidence to support a finding that arbitrage is so detrimental to the system that it creates such significant operating difficulties that the Commission needs to intervene in order to ensure adequate service to all of its customers.

19. Neither Southern nor any other commenter has shown that any arbitrage occurring under Southern’s cash-out provisions created such significant operating problems that Southern could no longer operate efficiently under those provisions. For example, there is no evidence that Southern ever had to issue an OFO or otherwise face an inability to provide service to some customers due to the imbalances run by other customers. Therefore, the Commission cannot make a finding that arbitrage on Southern’s system creates significant operating problems based on the facts before it in the instant proceeding, though evidence appears to show that gaming occurs to some extent on the system. The fact that the current cash-out method imposes certain costs on the parties

²³ General Motors Corp. v. FERC, 613 F.2d 939, 944-45 (D.C. Cir. 1979) (Commission has discretion whether to proceed on a Section 5 complaint).

²⁴ See Panhandle Eastern Pipe Line Co. v. FERC, 95 F.3d 62, 74 (D.C. Cir. 1996).

²⁵ Texas Eastern Transmission, L.P., 102 FERC ¶ 61,198, at P 104-05 (2003).

was anticipated by the March 10, 2000 Settlement. The March 10, 2000 Settlement resolved costs issues for its effective period. The Commission will not take action under Section 5 of the NGA to mitigate financial effects of a settlement without a showing of detriment to the system's operation.

20. As indicated above, Southern is not bound by the terms of its rate moratorium as of March 1, 2004. Since Southern supported changing its cash-out mechanism in its comments following the technical conference, the Commission assumes that once the moratorium ends Southern will propose such changes under Section 4 of the NGA. It appears that most elements of Southern's proposal to modify its cash-out provisions would reasonably ameliorate opportunities for gaming on Southern's system.²⁶ The Commission expects that any filing proffered by Southern to modify its cash-out provisions at the end of its rate moratorium, in addition to reducing gaming opportunities on its system, would clearly explain the relationship between its cash-out mechanism and its SCRM. Moreover, any such filing should address comments in the instant proceeding regarding the exclusion of poolers from the cash-out mechanism. Consistent with this discussion, the Commission denies Alabama Gas's requests for rehearing in Docket Nos. RP02-86-001 and RP03-123-001. The Commission also denies Southern's request for rehearing in Docket No. RP03-123-001 as moot, since the Commission is not ordering any refunds as a result of the technical conference. Similarly, the refund obligation in Docket No. RP04-79-000 is terminated.

The Commission orders:

(A) Refund obligations in SCRM filings in Docket Nos. RP03-123-000 on December 30, 2002, and RP04-79-000 on November 26, 2003, are terminated as discussed in the body of this order.

(B) Rehearing requests are hereby denied as discussed in the body of this order.

²⁶ In Texas Gas Transmission Corp., 96 FERC ¶ 61,318, reh'g denied, 97 FERC ¶ 61,349 (2001), the Commission suggested that Texas Gas take a less draconian measure to modify its tariff to prevent system gaming by proposing a mechanism that would inject an element of uncertainty regarding the eventual cash-out price, which would provide an incentive for shippers to remain in balance. 96 FERC at 62,220. The Commission accepted the proposal to inject uncertainty by adding the first week of the following month to the average of the four weekly prices used to determine the cash-out price. 97 FERC at 62,632. See also Texas Eastern, 102 FERC at P 105 (addition of a fifth week).

(C) The technical conference proceeding initiated by the December 30, 2002 order is terminated.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.